IT 96-43

Tax Type: INCOME TAX

Issue: Penalty Under 1002(d) - Failure To File/Pay Withholding

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
ADMINISTRATIVE HEARINGS DIVISION
CHICAGO, ILLINOIS

THE DEPARTMENT OF OF THE STATE OF II)	
v.)	No.
MAYDAYED)	SSN:
TAXPAYER,	_)	C. Ladewig
	Taxpayer)	Admin. Law Judge

RECOMMENDATION FOR DISPOSITION

<u>Appearances</u>: TAXPAYER, appearing *pro se;* Mr. Thomas P. Jacobsen, Special Assistant Attorney General, for the Illinois Department of Revenue.

Synopsis:

This matter comes on for hearing pursuant to the taxpayer's timely protest of Notice of Deficiency No. XXXXX issued by the Department on June 24, 1994 for withholding tax liability. Such Notice of Deficiency was issued to TAXPAYER (hereinafter "TAXPAYER" or the "taxpayer") as a responsible officer of COMPANY ("COMPANY") pursuant to Section 1002(d) of the Illinois Income Tax Act.

The issues to be resolved are 1) whether the taxpayer was a responsible officer of COMPANY Corporation and thereby required to collect, truthfully account for and pay over the tax imposed by Article 7 of the Illinois Income Tax Act and 2) whether the taxpayer willfully failed to collect, truthfully account for and pay over such taxes for the third quarter of 1989 through the fourth quarter of 1991 (hereinafter "tax period").

A hearing was held on December 28, 1994. Upon consideration of all the evidence, it is recommended that this matter be resolved in favor of the Department.

Findings of Fact:

- 1. The Department's prima facie case was established with the introduction into evidence of the Notice of Deficiency No. XXXXX dated June 24, 1994. Dept. Ex. No. 5. This Notice of Deficiency proposed a tax liability for failure to pay over to the State of Illinois income taxes withheld from employees of COMPANY for the third quarter of 1989 through the fourth quarter of 1991. Dept. Ex. No. 5.
- 2. The Department's Notice of Deficiency was prepared based on prior filings with the Department for 1988 and 1989 because the underlying corporate taxpayer failed to file withholding tax returns for the ten quarters involved. Tr. p. 10.
- 3. In approximately November of 1987, the company's loan was called due and the company gradually paid that loan with receipts of receivables. Tr. p. 16. As a result, the company's cash flow deteriorated. Tr. p. 16.
- 4. TAXPAYER was hired in November of 1986 as accounting manager and held the positions of controller, vice-president of finance and chief financial officer during the tax period. Records indicate that he had assumed the title of vice-president of finance by at least August of 1990. Tr. pp. 14, 20, 27-28.
- 5. As controller, TAXPAYER was primarily responsible for the accounting department where he supervised approximately six people. Tr. p. 22. He was responsible for preparing financial statements, keeping financial records, banking and assisting with administrative duties. Tr. p. 21. TAXPAYER controlled day-to-day operations under COMPANY's president, PRESIDENT's, supervision. Tr. p. 24.
- 6. TAXPAYER opened bank accounts for the corporation during the tax period in question (Tr. pp. 24, 25) and was a signatory on the corporation's BANK

Savings account. Tr. p. 28. The BANK account was opened in June of 1987 and remained open through 1991. Tr. pp. 28, 29. The Skokie account was opened February 2, 1988. Tr. pp. 28, 29. TAXPAYER could not recall whether this account remained open the entire tax period. Tr. p. 29; Dept. Ex. No. 6.

- 7. TAXPAYER reviewed the monthly checking account statements which showed deposits and disbursements. Tr. p. 58. He was aware that the bank was returning checks due to insufficient funds. Tr. p. 58. Either PRESIDENT, TAXPAYER or their assistants would prepare the deposits daily and TAXPAYER was aware of at least the total deposits. Tr. p. 59.
- 8. TAXPAYER' responsibilities also included determining whether paychecks were cashed or not. Tr. p. 20. In approximately August of 1990, TAXPAYER told employees not to cash their paychecks due to insufficient funds (Tr. pp. 18, 33), however, he was aware that some paychecks were cashed after that time. Tr. p. 20.
- 9. When taxpayer was promoted to vice-president of finance he continued to handle these same responsibilities in addition to his new ones. Tr. pp. 21, 22.
- 10. TAXPAYER was responsible for the hiring and firing of accounting personnel between 1986 and 1991. Tr. p. 23. These decisions were subject to PRESIDENT's approval, although he never questioned TAXPAYER' discretion in this area. Tr. p. 23. TAXPAYER did, in fact, participate in the decision to fire an individual who was most likely the only person fired during the tax period. Tr. pp. 23, 24.
- 11. TAXPAYER had discretion to draw up checks to pay suppliers during the tax period. Tr. p. 32. These checks were prepared by the accounting department under his authority from 1986 through 1991 (Tr. p. 32) and TAXPAYER signed them in the regular course of his duties as controller and chief financial officer. Tr. p. 30.
- 12. Taxpayer prepared the bank reconciliations and therefore, was aware of the bank balances. TAXPAYER knew there was a negative cash flow long before the corporation stopped paying the employees. Tr. p. 34. TAXPAYER, PRESIDENT or

PRESIDENT's administrative assistant signed these payroll checks as part of the normal operating procedure. Tr. pp 34, 35. TAXPAYER was aware that a signature stamp was used on occasion in lieu of his original signature. Tr. p. 30.

- 13. Payroll checks were prepared by an outside payroll service and TAXPAYER reviewed the preparation of these checks. Tr. pp. 32, 33. TAXPAYER was aware of the details of the payroll and knew that deductions were taken for Illinois income tax. Tr. p. 38. He reviewed the payroll register and the information and reports prepared by the payroll service. Tr. pp. 37, 38.
- 14. When the cash flow was positive the payroll service drew money from COMPANY's accounts and the payroll checks were written on the service's accounts. Tr. p. 38, 39. TAXPAYER reviewed the IL-941 returns prepared by the payroll service as part of his general responsibility as controller, vice president of finance and chief financial officer (Tr. pp. 40, 41) and therefore, would have been aware that an IL-941 was not filed. Tr. pp. 44, 45. He was uncertain whether returns were filed for the period of 1986 through 1991 (Tr. p. 41) although he did admit he was aware that the withholding tax was not paid to the State of Illinois prior to leaving COMPANY (Tr. pp. 41, 61) and could produce no evidence to dispute that the second quarter of 1989 was the last filed return. Tr. p. 43.
- 15. TAXPAYER was aware that the corporation was paying other bills after the third quarter of 1989 and in fact, signed many of these checks. Tr. pp. 46, 53; Dept. Ex. No. 7.
- 16. COMPANY made more than a hundred disbursements a month. Tr. p. 54. At some point, the corporation was paying only the bills necessary to keep the operation going. Tr. p. 55. TAXPAYER was aware that portions of the utilities were being paid until notice was given that service was being discontinued and then another portion was paid. Tr. p. 55. TAXPAYER also knew the corporation was delinquent in their payments to the landlord. Tr. p. 55.

- 17. TAXPAYER prepared projections of COMPANY's future sales and costs for prospective buyers. Tr. p. 56. TAXPAYER assumed that some type of payment plan would be entered into with the State with respect to the company's unpaid tax liability and projected these assumptions. Tr. p. 57. He prepared these forecasts before and during the tax period. Tr. p. 57.
- 18. TAXPAYER was unable to produce a resignation letter at hearing to support his contention that he left COMPANY in approximately March of 1991. Tr. pp. 17, 18.

Conclusions of Law:

Section 1002(d) of the Illinois Income Tax Act imposes a penalty on:

... any person required to collect, truthfully account for, and pay over the tax imposed by this Act who willfully fails to collect such tax or truthfully account for and pay over such tax or willfully attempts in any manner to evade or defeat the tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the amount of the tax evaded, or not collected, or not accounted for and paid over

35 **ILCS** 5/1002(d).

35 **ILCS** 5/1002(d) is modeled after Section 6672 of the Internal Revenue Code, which imposes liability upon those individual persons actually responsible for an employer's failure to withhold and pay over the taxes. Allen v. United States, 547 F. Supp. 357 (N.D. Ill. 1982).

In determining whether an individual is a responsible person the courts have indicated that the focus should be on whether that person has significant control over the business affairs of a corporation, or whether that person participates in decisions regarding what bills should or should not be paid and when. See, e.g. Bloom v. United States, 272 F.2d 215 (9th Cir. 1959). The "key to liability" is significant control or authority over an enterprise's finances or general decision-making. Purdy v. United States, 814 F.2d 1188 citing Haffa v. United States, 516 F.2d 931 (7th Cir. 1975).

The court in <u>Silberberg v. United States</u>, 524 F. Supp. 744, 747 (E.D. N.Y. 1981), outlined five factors which give guidance in determining whether an individual is a responsible person under the Act: (1) the corporate identity of the individual (whether such person is an officer, employee, director or shareholder), (2) his/her duties as outlined in corporate by-laws, (3) the extent to which the individual has control over the financial affairs of the corporation and (5) whether that individual can hire and fire employees.

Although title alone is insufficient to constitute a finding of responsibility, TAXPAYER' positions of accounting manager, controller, vice president of finance and chief financial officer are indicia that taxpayer held positions that entailed a great amount of authority and responsibility for handling the corporation's finances. Furthermore, TAXPAYER' testimony at hearing indicated that he was not merely a figurehead at COMPANY but rather participated in the day to day operations, supervised the entire accounting department, prepared financial statements and handled the corporation's banking. TAXPAYER admitted that he had discretion to draw checks and the Department produced checks paying utilities and expenses with TAXPAYER signature. Taxpayer and PRESIDENT both made the decisions regarding hiring and firing of personnel. He signed checks, opened and was a signatory on corporate bank accounts. TAXPAYER also worked with the payroll service and reviewed their worksheets and summaries. TAXPAYER had the power and responsibility within the corporation for ensuring that the taxes were remitted and yet failed to do so, and the mere fact that other officers also had control over financial matters does not exonerate TAXPAYER from liability. See, Gephart v. Unites States, 818 F.2d 469 (6th Cir. 1987). Based on the foregoing, I believe sufficient evidence was presented to establish that TAXPAYER was intimately involved in corporate policy and the daily decision making and was a responsible person as required in the statute.

It must also be determined whether TAXPAYER willfully failed to remit the withholding taxes to the Department. Willfulness in regards to Section 1002(d)

is not merely limited to "intentional, knowing and voluntary acts". Young v. \overline{IRS} , 85-1 USTC par. 87521. Willful as applied in Section 6672, and hence 1002(d), "encompasses voluntary or intentional acts, or actions exhibiting a reckless disregard of a known or an obvious risk that tax monies have not been remitted to the taxing entity". $Id.^2$

Willfulness may be also be established by a showing of gross negligence involving a known risk of violation. Wright v. United States, 809 F.2d 425 (7th Cir. 1987) (a person can be liable if she "(1) clearly ought to have known that (2) there was a grave risk that withholding taxes were not being paid and if (3) she was in a position to find out for certain very easily").

The record indicates that TAXPAYER' knew COMPANY was having difficulty meeting its financial obligations and that there were insufficient funds to meet its payroll. Tr. p. 58. TAXPAYER admitted he was aware that the corporation was in arrears with the Department. Tr. pp. 57, 61. At hearing he stated that the company hoped for a payment plan with respect to its delinquent tax liability and included such a plan in his forecasts and projections for potential buyers of the corporation Tr. p. 57. TAXPAYER had detailed knowledge of the extent of the corporate liability as evidenced by its inclusion in his forecasts and projections.

Willfulness "is present if the responsible person had knowledge of the tax delinquency and knowingly failed to rectify it when there were available funds to pay the government". Gephart v. U.S., supra. TAXPAYER reviewed the summary reports prepared by the payroll service and was aware of the

The Illinois Supreme Court in Department of Revenue v. Heartland Investments, 106 Ill.2d 19, 29 (1985), accepted that cases arising under section 6672 of the IRC provided guidance in determining the meaning of the "willful failure" requirement of Chapter 120 par. 452 1/2 (13 1/2). See, e.g. Carl E. Branson v. The Department of Revenue, 168 Ill. 2d 247 (1995). The court was addressing the Retailers' Occupation Tax Act, however, not only are the underlying policies of the ROT section and section 1002(d) similar but the language of the two section encompasses both responsibility and willfulness.

². Courts have indicated that the determination of whether an employee knowingly, voluntarily and intentionally fails to remit such tax is "an issue of fact to be determined by the trier of fact on the basis of the circumstances and evidence adduced in the particular case." Department of Revenue v. Bublick, 68 Ill.2d 568, 577 (1977).

insufficient funds in the corporate payroll account. TAXPAYER' contention that PRESIDENT was solely responsible for decisions regarding payment of creditors is not supported by the record. In fact the record shows TAXPAYER admitted he had discretion to draw checks, he signed these checks in the normal course of business and at hearing the Department produced checks to creditors which TAXPAYER had signed. Despite his knowing that the company's liabilities to the State were unmet, TAXPAYER continued to pay creditors other than the Department. The courts have established that preference to creditors over the Department during the tax period is behavior sufficient to constitute willfulness. See, Monday v. United States, 421 F.2d 1210, (7th Cir. 1970); Department of Revenue v. Heartland Investments, supra.

Lastly, TAXPAYER contends that he resigned from COMPANY in March of 1991, although he offered no evidence at hearing to support his assertion. "In order to overcome the presumption of validity attached to the Department's corrected returns" the taxpayer "must produce competent evidence, identified with their books and records." Copilevitz v. Department of Revenue, 41 Ill.2d 154 (1968); Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1st Dist. 1978). Oral testimony is not sufficient to overcome the prima facie correctness of the Department's determinations. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826 (1st Dist. 1988). Taxpayer contends that he resigned in March of 1991 and is not liable for any taxes after such period, however, this statement, without further competent evidence is insufficient to overcome the Department's prima facie case.

WHEREFORE, for the reasons stated above, it is my recommendation the Notice of Deficiency be finalized as issued.

Enter: Date: